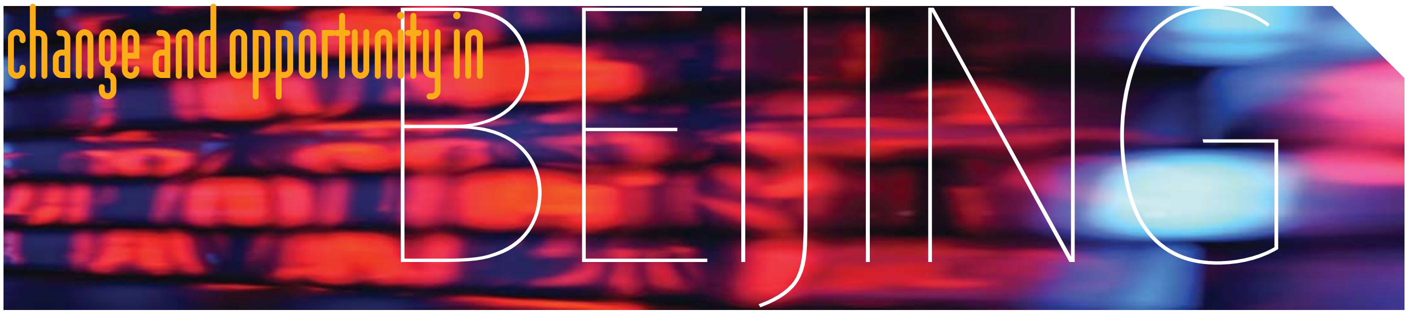

change and opportunity in BEIJING

"The city of Beijing has become a different place," says Laurence Bailey, business executive of JPMorgan Investor Services Asia Pacific region. His observations are confirmed by visitors who remark that, compared to just 10 years ago, the city of Beijing would be almost unrecognizable to a returning visitor today. Beijing has undergone a transformation into a modern city now characterized by wide boulevards, new hotels, restaurants and modern shops selling designer clothes. This change has not only meant an increase in Beijing's tourism but has also spawned an increase in the level of foreign interest and investment.

According to www.cbsmarketwatch.com Beijing reported a 9.7% increase in its economy in the first quarter of 2004. "With 1.3 billion people in China, many thought the speed of change would be much slower," Bailey says. "But where the trend in the last few years had been toward investing into China, the trend now is shifting toward Chinese investors who want to invest their own funds cross border," reflecting a growing affluence among Beijing's middle class.

Traditionally owners of all aspects of the financial chain, Chinese banks have started using the services of western banks and global custodians for custody, accounting, performance and securities lending. While the statistics are difficult to justify, as there are no published tables/records to date, Bailey believes JPMorgan Investor Services is one of the largest global custodians in China at the moment. "The local Chinese banks used to only invest through Euroclear, but they've started broadening their relationships with global custodians as the services they require increase. Investor Services is well positioned to support these banks as well as insurance companies that are likely to start investing overseas in the near future," he says.

Proceed with Caution, Phenomenal Growth Ahead

With all the positive developments in China's market, Bailey does express some caution regarding the highly competitive environment in the country right now. "The challenge," he says, "is to understand that the financial dynamics of Asia are very different when compared to western ways. In the west, business is focused on quarterly profitability. My fear is that expectations for quick profits have resulted in an influx of investors into the country, many of whom lack the understanding of how the Asian markets work. This could cause companies to become disenchanted quickly when those immediate profits don't materialize."

"We can't let standards and controls fall by the wayside in deference to winning new business. In other words, we can't let the western way of traditionally doing business distract us if we don't see an immediate return," he says. "While we're all keen to get the next deal," Bailey explains, "people have to be realistic about what that entails.

"Not many companies are brave enough to invest large amounts of capital and ride out the uncertainty of ROI. It's a really interesting situation," he says.

In addition to the highly competitive environment, the topic of Renminbi (RMB), China's legal tender (see sidebar p. 17), appreciation and its impact on the world economy have been dominating economic headlines. With more and more multinational enterprises and financial institutions wanting to do business with China, it is the RMB exchange rate, as well as its offshore clearing capacity that is attracting attention. Last November, China's central bank announced its plan to allow banks in Hong Kong to offer limited offshore RMB services, which has been perceived as a symbolic reflection of RMB stepping towards an international currency, all indicating a direction and a determination on deregulation by the Chinese government.

On a recent visit, Bailey made a presentation to the China Risk Forum, a unique open forum of nearly 80 representatives from China's banks, fund management and insurance companies. The Forum focused on the topic of risk and featured presentations by Investor Services settlement risk and DVP, as well as its sister Treasury & Securities Services (TSS) business, Treasury Services, talking about operational risk and its Horizon product. In addition, the JPMorganFleming Asset Management team reviewed the market investment risks associated with the process of investing. "The Forum was very well received," Bailey says. "The Chinese are very anxious to further understand and learn all there is to know about global investing. They attend seminars; they send their people around the world to take in as much information as possible. As a result they are developing a new wave of investments and products."

Putting Down Roots

China opened its A-share market to foreign institutional investors in 2003, when it introduced the Qualified Foreign Institutional Investors (QFII) scheme. The scheme permits select foreign investors to buy yuan-denominated securities previously reserved for Chinese nationals. To date, China has granted QFII status to 15* overseas investors. JPMorgan attained QFII approval in November of last year, which allows the firm to tap into the debt and the $500 billion RMB-denominated main stock markets in China.

Several of JPMorgan's team's already have a presence in China. The firm has three JPMorgan Chase bank branches in Beijing, Tienjian and Shanghai. It's sister TSS businesses, Treasury Services and Institutional Trust Services, have representation in the Beijing branch. Investor Services currently services Beijing from its Hong Kong office but is investigating putting down its own stake there. After a recent visit to China, Tom Swayne, Investor Services business executive said, "I am particularly excited about our growing market opportunities in China. With a few people on the ground our opportunities are even more appealing."

Bailey describes Beijing's atmosphere as dynamic. "When you're there, the city exudes a sense of change and opportunity. Of all the countries in Asia, I think China is really on a mission." ○○○

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* As of May 13, 2004 source: www.chinaeconomicreview.com

facts about beijing

Beijing is the capital of the People's Republic of China. It is the nation's political, economic, cultural and educational center as well the most important center in China for international trade and communications. Beijing will be the site of the 2008 Olympics.

Population

13.82 million

Currency

The Chinese legal tender is Renminbi, or RMB, meaning "people's money." The basic unit of RMB is yuan. 1 yuan is equal to 10 jiao, and 1 jiao is equal to 10 fen. Yuan and jiao are issued mostly in notes. There are 1 yuan, 5 jiao, 2 jiao and 1 jiao coins, and 1 fen notes and coins.

Geography

Located in the north of the Huabei (North China) Plain in the North Temperate Zone.

Longitude: Between 115° 25′ and 117° 30′ East

Latitude: Between 39° 28′ and 41° 05′ North

Natural Resources

Beijing has a diversified physiognomy with plains, mountains and hills. The large areas of rocky mountains and the unfavorable quality of soil and inadequate water supply limit the utilization of land. At least 67 kinds of mineral resources have been discovered; iron and limestone, and some other minerals are mined. Forest coverage is less than the national average, and the population of wild animals has been reduced significantly.

Climate

Average temperatures in August: High 84° to 88° F, Low 67° to 71° F

Area

16,800 square kilometers (6,487 square miles)

Source: www.travelchinaguide.com, www.citsusa.com/currency

macroeconomic environment in china

China is now the sixth-largest economy in the world, with GDP of $1.4 trillion. Inbound foreign direct investment totals $1 billion per week. China's rapid growth is challenging its physical infrastructure, including roads and rail, natural energy and utilities. Widespread power outages resulting in plant closures are expected this year.

Inflationary pressures are also increasing in China, with rising prices for raw materials, grain and labor. Foreign investment in two key services sectors, financial services and logistics, both required for competition and development, are restricted but continue to increase.

Concerns remain about weaknesses in the banking sector and inefficiencies in capital allocation. Unrestrained lending practices have contributed to overcapacity and related deflationary risks. Analysts also anticipate a shift in China's currency regime that will have the effect of revaluing the yuan against the dollar around the middle of 2004, causing a 6% appreciation against the dollar by the end of the year. Once China revalues, monetary authorities elsewhere in Asia will likely allow their currencies to appreciate against the dollar.

China's economic trends will influence markets globally. The risks present in its economy, and the resulting volatility in prices, offer an uncertain market for China trade and manufacturing.

Source: Excerpted from *JPMorgan Bulletin*, "Textile and Apparel Quota Elimination in 2005."

For more information, or to obtain a copy of the bulletin in its entirety, contact Kirk Stirling at 212.552.5128 or at kirk.stirling@jpmorganchase.com